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C O N F I D E N T I A L SECTION 01 OF 03 BRASILIA 000572

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TAGS: [PGOV](#) [ECON](#) [SOCI](#) [KCRM](#) [BR](#)

SUBJECT: WORST OF BRAZILIAN SCANDAL HAS PASSED

REF: A. BRASILIA 402

[B](#). BRASILIA 458

[C](#). BRASILIA 564

[D](#). SAO PAULO 378

Classified By: POLOFF RICHARD REITER, FOR REASONS 1.5 B AND D.

[1](#). (C) SUMMARY. On March 4, Brazil's Workers' Party (PT) quashed efforts to set up a congressional inquiry (CPI) into the gaming sector and the "Waldomiro Diniz" scandal (refs A,B). This, coupled with the fact that no new allegations pointing to wrongdoing by PT leaders have emerged in recent days, suggests that the worst of the scandal has passed. Lula's Chief of Staff, Jose Dirceu, was emboldened to give a defiant press interview in VEJA magazine. The post-mortem shows that the winners include PMDB Senator Jose Sarney, who gave key support to the administration in quashing the CPI. Losers, aside from Dirceu, include PT Senator Aloizio Mercadante and PL Senator Magno Malta. Other big losers are the nation's more than 120,000 bingo parlor employees put out of work when Lula closed the parlors February 20.

[2](#). (C) And of course the Workers' Party has lost political capital. It is too early to say whether the scandal will hurt the PT in October's municipal elections, but it is likely to slow the legislative agenda in an already compressed congressional year. The PT may also emerge more dependant on its coalition partners (who will extract maximum benefits in return), particularly the PMDB, which was instrumental in saving the PT from worse disgrace. The PT's poor response to the crisis is in part due to its inexperience with ethics scandals, but the party is likely to discover that learning these lessons is politically expensive. END SUMMARY.

CONGRESSIONAL INQUIRY GETS PUT IN A DRAWER

[3](#). (SBU) On March 4, three weeks after the "Waldomiro Diniz" scandal broke --in which a senior advisor on President Lula's staff was caught soliciting bribes from a numbers racketeer-- the Workers' Party used a parliamentary tactic to quash efforts to establish a congressional inquiry (CPI). The CPI was sponsored by Senator Magno Malta, of the coalition's Liberal Party. On March 4, Malta filed his petition with the Senate leadership, but the fix was already in. Senate President Jose Sarney, a leader of the coalition's PMDB party, went ahead and authorized the CPI, but then neither the PT nor the PMDB nominated their members to the committee. Without a quorum, the committee could not be established and, in the lexicon, was "put in a drawer". Investigations by the Federal Police, the Federal Prosecutor, and the Rio state assembly still continue. With the CPI threat gone, and the fact that no new allegations against PT leaders have emerged in recent days, the worst of the scandal appears to have blown over.

JOSE DIRCEU FINALLY GOES PUBLIC

[4](#). (U) In fact, Lula's embattled Chief of Staff Jose Dirceu, for whom Waldomiro Diniz worked, felt emboldened enough to make his first public statement when he gave a long interview for the March 10 issue of VEJA magazine. Defiant, Dirceu wondered why the opposition politicians who now say they have known about Diniz's malfeasance for over a year did not raise the issue earlier. Saying that he made a mistake in trusting Diniz but committed no crime, Dirceu confirmed that Lula refused his offer to resign. He insisted that the scandal is not an "institutional crisis" and that the Workers' Party maintains its "standard of ethical behavior and transparency".

LEGISLATIVE AGENDA A TOUGH SELL

[5](#). (C) The Lula administration and the PT have not emerged unscathed. Lula's personal approval remains at a teflon 60%, but his government's popularity has slipped to 38% (ref C). Even PT politicians tell us that the administration will have to work harder to sell its bills in Congress and may have to offer more pork to coalition allies. Congress is now turning to its legislative agenda (one PT Federal Deputy told us that when the PT caucus in the lower house held its weekly meeting on March 9, crisis management was not even on the agenda), which in the coming weeks will include the Energy Model, Public-Private Partnerships, a Bankruptcy Law, follow-on

legislation for last year's tax and pension reforms and possibly judicial reforms. (A bill to reform campaign financing, which got an early boost from the scandal, has once again been put on the back burner.) The legislative plate is full of tough bills, and with municipal elections set for October, Congress will essentially stop working when it goes into recess on June 30.

WINNERS...

16. (SBU) The post-mortem on the scandal is still being written, but there are some clear winners and losers. Among the winners are Senate President Jose Sarney (PMDB) who provided sound advice and procedural support in helping the administration quash the CPI. Rumors that Sarney will be rewarded by getting to name the next head of Eletrobras have resurfaced, and it is rumored that the PT will support Sarney's bid to amend the constitution to allow him to remain as Senate President through 2006. Similarly, leading PMDB Senator Renan Calheiros and Chamber Speaker Joao Paulo Cunha (PT) worked hard on the administration's behalf and will expect recognition. Meanwhile, former-Rio Governor Anthony Garotinho, who came in third in the 2002 presidential elections, is positioning himself for another presidential run in 2006. Though Garotinho heads Rio's PMDB branch --and the PMDB is part of Lula's coalition-- he did not miss the opportunity to slam the administration over the Diniz scandal.

...AND LOSERS

17. (C) The list of losers from the Diniz scandal must start with Chief of Staff Jose Dirceu. He appears to have dodged the bullet, in that there is no evidence that he was personally involved in corrupt activities. But Diniz worked for him, and there are still unanswered questions about Dirceu's role in both the Diniz and Celso Daniel (ref D) cases. Dirceu is convinced that another member of Lula's inner circle, Communications Secretary Luiz Gushiken, tried to undermine him with tactical leaks over the past weeks, and Lula reportedly had to mediate their dispute. In a March 2 poll (ref C), two-thirds of Brazilians said Dirceu should step down, either temporarily or permanently, from his post.

18. (SBU) Leading PT Senator Aloizio Mercadante also came out badly. It was he who gave disastrous tactical guidance to the PT caucus in the Senate that nearly resulted in the CPI being established. (There is some speculation that Mercadante may be replaced by Calheiros as the coalition's floor leader in the Senate.) Liberal Party Senator Magno Malta, leader of the PL's Senate caucus, was badly damaged by his insistence on requesting the CPI, despite the fact that the administration and PL leadership were opposed. (The PL is a coalition member and the party of Vice President Alencar.) Malta gave a tearful mea culpa on the Senate floor on March 9, but he may be forced out of his leadership position, if not out of the party altogether.

BINGO PARLORS OUT OF LUCK

19. (C) Bingo parlors are losers, and an estimated 120,000 or more gaming employees are out of work. On February 20, Lula issued a decree closing all bingo games and slot machines in Brazil. Bingo was originally legalized in 1993 to allow gaming houses to affiliate with sports clubs and donate 7% of their revenues to the clubs' upkeep. However, many clubs complain that they never received the promised bingo revenues. PT Federal Deputy Jose Eduardo Cardozo told us the system is "a fraud", and the bingo parlors are simply money laundering operations. PT floor leader Arlindo Chinaglia assured us that Congress will support Lula's decree (which must be approved by Congress to remain in force), and no thought is being given to reopening the parlors anytime soon.

WORKERS' PARTY IMAGE TARNISHED

10. (C) And of course the Workers' Party has lost political capital. It is too early to say whether the scandal will have an impact on October's municipal elections, and there are still seven months for the party to recover, but the declining popularity of the PT-led administration indicates that the party has suffered a black eye. The PT's code of ethics is more than just image (of 76 members of Congress who are currently defendants in criminal or electoral cases, none is a PT member), but the spate of bad press is damaging, and PT candidates will be hard-pressed to point fingers at their opponents' misdeeds in the election run-up.

11. (C) The PT showed itself inexperienced in crisis management, precisely because it is rarely faced with ethical crises. The fact that it was saved by behind-the-scenes support from figures like Senators Jose Sarney and Antonio Carlos Magalhaes, both widely perceived as ethically-challenged, but who have therefore developed superb crisis management skills, is surely not lost on the public or the Workers' Party rank-and-file. The PT learned some tough lessons that it hoped never to need, and finds itself

diminished as a result.

COMMENT - PT NOW A HOSTAGE?

12. (C) Pundits here wonder whether, and to what extent, the PT now finds itself held hostage by its coalition allies. The large PMDB party, in particular, is never shy about demanding pork, the right to fill federal job vacancies, compromises on controversial legislation, and now deals on local-level coalitions in the upcoming elections. One PT Deputy told us with a sigh that campaign finance reform and labor reform will not pass this year because the PT will have to limit its exposure on controversial bills. There still may be time and political capital to pass important legislation, but the expectations have been sharply reduced by the scandal. This is surely not how Lula and the PT wanted to begin their second year.
VIRDEN